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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

Arizona Corporation Commission

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MAR 16 1998

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IN THE MATTER OF THE COMPETITION)
IN THE PROVISION OF ELECTRIC)
SERVICES THROUGHOUT THE STATE OF)
ARIZONA)

DOCKET NO. U-00000C-94-165

SUPPLEMENTAL INITIAL BRIEF OF ARIZONANS
FOR A BETTER ENVIRONMENT

This brief supplements the Initial Brief Regarding Stranded Costs submitted jointly by the Land and Water Fund of the Rockies ("LAW Fund"), the Grand Canyon Trust and Arizonans for a Better Environment ("ABE"). This brief is submitted solely on behalf of ABE, in order, pursuant to the March 3, 1998, Procedural Order, to briefly to set forth ABE's position on the issues posed in the Hearing Officer's December 1, 1997, Procedural Order and December 11, 1997, First Amended Procedural Order. In addition, ABE wishes to set forth some of its thoughts regarding the spectre-like issue that has haunted these proceedings: the so-called "regulatory compact" or "bargain."

1 As set forth in the aligned intervenors' aforementioned
2 Initial Brief Regarding Stranded Costs, ABE joins the LAW Fund
3 and Grand Canyon Trust in their positions and recommendations
4 regarding issues 3, 3a, 6 and 9 and the proposed subsection
5 12. Initial Brief of LAW Fund, *et al.*, pp. 2-3. ABE's
6 concerns regarding several other issues raised by the Hearing
7 Officer were set forth in its response to issues for possible
8 settlement, embodied in RUCO's issues matrix of February 9,
9 1998. ABE's issues matrix response represents its positions and
10 concerns at the close of the evidentiary portion of these
11 proceedings, as well as at the outset. Therefore, that portion
12 of the issues matrix setting forth ABE's position is attached
13 hereto and incorporated by reference and constitutes its
14 position summary pursuant to the March 3rd Procedural Order.
15 Exhibit 1.

16 ABE's primary concerns entering these proceedings were
17 that any stranded cost recovery granted utilities mirror free
18 market mechanisms as closely as possible, that programs
19 instituted by the Commission to achieve social goals and to
20 internalize external costs (such as pollution and energy
21 inefficiency) be preserved where feasible and appropriate, and
22 that administered costs to consumers continue to be allocated
23 so as to send accurate and appropriate price signals to the
24 various classes of consumers. ABE's aforementioned Initial
25 Brief with LAW Fund, *et al.*, addresses each of these concerns.

26 In particular, ABE wants to stress its view that programs
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2 such as the Solar Portfolio Standard and demand-reduction
3 incentives are not mere add-ons to the market-based or
4 administered price designed to achieve social goals. Rather,
5 they reflect true market value and externalized costs. Such
6 programs function as a constructive surrogate for external
7 environmental costs that might not be captured in and reflected
8 in price even in a fully market-based setting, owing to market
9 imperfections. Non-utility actors in the market routinely
10 and appropriately face such internalization of external costs
11 in today's society and treat it merely as a necessary cost of
12 doing business. Any argument that such programs must be
13 abandoned during the transition from a system of administered
14 prices to a new era of market-based competition is untenable.

15 In other words, ABE agrees that a market approach
16 potentially is the most efficient and, given reasonable
17 correctives for market imperfections, socially responsible
18 form of "ratemaking" and cost allocation. In years past,
19 ABE has consistently urged that regulatory practices mirror
20 a true market as fully as possible. If competition and partial
21 deregulation are not to result in market-distorting advantages
22 to the previously regulated and still partially regulated, local
23 utilities, the determination of stranded costs, too, must mirror
24 the market as fully as possible.

25 It is essentially uncontroverted on the record that full
26 divestiture is single market-based approach available for the
27 determination of cost. Moreover, the Commission clearly has
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2 authority to require divestiture as a condition of full stranded
3 cost recovery. Initial Brief of LAW Fund, et al., p. 4.

4 Those utilities that argue against divestiture and
5 market-based means of determining stranded costs seek to carry
6 forward into the competitive future the vestiges the regulated
7 monopoly status from which they benefitted (or had the
8 opportunity to benefit) in the past. In support of that
9 position, the utilities commonly cite the concept of the
10 "regulatory compact" or "bargain" - or, as it facetiously has
11 become known in these proceedings, the "regulatory banana."
12 Throughout these proceedings, however, the utilities have been
13 unable to persuasively cite a single applicable legal precedent
14 mandating the regulatory bargain concept. The regulatory
15 bargain is not a legal rule. It is merely a construct embodying
16 one of several theories of regulation, none of which has the
17 force of law.

18 Moreover, that construct ignores certain realities, even,
19 of the old era of regulated monopolies. The gist of the
20 regulatory bargain concept is the claim that regulated utilities
21 face onerous obligations (primarily the obligation to serve
22 demand) that are not applicable to free-market actors.
23 Therefore, the theory claims, regulated utilities are
24 entitled to something more generous than market-mirroring
25 regulation. Implicit in this argument is the recognition
26 that, normally, no takings claim could be based on market-

1 mirroring price regulation, absent the purported special
2 obligations. The force of those arguments is blunted in
3 Arizona where, historically, the Commission has lacked legal
4 authority over utility decisions to build new facilities in
5 purported fulfillment of that obligation.

6 Generally throughout the country, moreover, utilities for
7 decades used the regulatory bargain concept to shield themselves
8 from anything remotely resembling market discipline, from the
9 planning stage through decommissioning. The result has been a
10 system of "cost-plus" regulation, under which clearly erroneous
11 utility decisions regarding both costs and demand never had to
12 be revisited (as routinely occurs in true markets). That system
13 created incentives to build economically inefficient,
14 environmentally dangerous or dubious mega-plants that a free
15 market never would have supported. See Transcript, Vol V, pp.
16 1652 line 7 through 1653 line 18 (Testimony of Mr. Bayless). It
17 is those plants, especially, that will form the bulk of stranded
18 costs if the utilities' regulatory bargain concept is embraced
19 by the Commission. As a result, the distortions of the era of
20 regulated prices will be carried forward into and will distort
21 the new era of competition.

22 This legally need not occur. The utilities' theory of
23 a regulatory bargain ignores the substantial benefits received
24 from the old regulatory system. Those benefits included
25 shielding from market price discipline, shielding from
26 ongoing review of products, projects and investments, legally

1 enforced monopoly status, and almost absolute *de facto*
2 protection from the ultimate market disciplines of failure and
3 bankruptcy. There can be little doubt that, in a competitive
4 market, utilities such as Arizona Public Service and Tucson
5 Electric Power could not have survived to the year 1998, or
6 that, to survive, they would have been forced to divest
7 themselves of investments such as, e.g., Palo Verde.

8 The fact that those utilities do still exist is ample
9 evidence that the benefits to the utilities of the so-called
10 regulatory bargain far exceeded the demands upon them. Nor can
11 it be denied that the old system of monopoly regulation arose
12 with the active support of larger utilities and functioned to
13 prevent competition - in itself a tremendous advantage seldom if
14 ever acknowledged by proponents of the regulatory bargain
15 theory.

16 In exchange for the alleged burdens of monopoly
17 regulation, moreover, the utilities were able to force their
18 captive customers to bear the costs of utility errors, a
19 complete inversion of market-based consumer sovereignty.
20 Thus, the purported regulatory bargain offered reciprocal
21 advantages to the utilities in every sense. Those advantages
22 far outweighed the purported burdens on regulated utilities.
23 Where an "average reciprocity of advantages" exists, it is well
24 established that there can be no viable claim of regulatory
25 taking.

26 Ultimately, there is no "set formula" for deciding these

1 issues. Penn Central Transp. Co, v, New York City, 438 U.S. 104
2 (1978). Certainly, the mythic, extra-legal "regulatory bargain"
3 provides no such formula. Rather, the appropriate inquiry for
4 the Commission is what, upon the particular circumstances of the
5 instant case, fairness and justice require. Ibid. In this
6 case, ABE submits, fairness and justice, as well as sound
7 economic and social policy, require that the competitive future
8 not be burdened by the dead weight of the antiquated regulatory
9 bargain concept.

10 **RESPECTFULLY SUBMITTED** this 16th day of March, 1998.

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13 

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17 AN ORIGINAL AND TEN COPIES
18 of the foregoing filed this
19 9th day of February, 1998 with:

20 Docket Control
21 Arizona Corporation Commission
22 1200 West Washington
23 Phoenix, AZ 85007

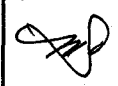
24 COPY OF FOREGOING mailed this
25 9th day of February to all parties.
26 (Service list attached.)
27
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EXHIBIT 1

of Arizonans for a Better Environment

STRANDED COST DOCKET ISSUE MATRIX
PARTIES THAT DID NOT FILE TESTIMONY

	1. Should the Rules be modified regarding s/c? If so, what major modifications to the Rules are necessary?	2. When should Aff'd Utilities make stranded cost filings?	3. What costs should be included in s/c and how should those costs be calculated?
Arizona Municipal Power Users Association			

Arizonans for a Better Environment	<p>No erosion of consumer protections. Absent divestiture (the ABE-preferred alternative) rules should reflect market-based method of determining stranded cost value (provisionally, a la Goldwater Institute, Electric Competition Coalition approaches). If an administrative approach is employed, Rules should address value and effect of non-price factors on calculation of market value (Land & Water Fund approach, which ABE supports). If cost-sharing approach (a la RUCO, which ABE could support as "second-best" to market-based approach) adopted, rules should be modified per RUCO's recommendation. Clarify mitigation requirements. Clarify factors considered in allowing recovery of stranded costs. Clarify nuclear waste and decommissioning rules (a la Electric Competition Coalition). Clarify Rules to show that antitrust laws apply to deregulated electric generation.</p>	As soon as practicable after Order (or divestiture) and at least six months before rates are charged.	<p>If appraisal approach adopted, nuclear waste and decommissioning costs should be rolled into appraisal. Assuming non-market approach, ABE agrees with Land & Water Fund that reliability and other factors beyond market price should enter into calculation of stranded costs and provisionally supports RUCO's recommendations on this question.</p>
Center for Energy and Economic Development			
City of Phoenix			

	3a. What is the recommended calculation methodology, and what assumptions are made, including determination of market clearing price?	3b. What are the implications of SFAS No. 71 resulting from the recommended s/c calculation and recovery methodology?
Arizona Municipal Power Users Association		
Arizonans for a Better Environment	ABE supports divestiture and market-based (appraisal) approaches. ABE opposes net revenue lost approach. If administrative approach employed, reliability, efficiency and other factors should be considered. Relatedly, pollution control and similar costs (constituting legitimate price-internalization of external costs) should not be treated in such a manner as to produce a windfall to utilities and shareholders.	ABE has no comment at this time but will review any testimony, points and authorities filed on this issue.
Center for Energy and Economic Development		
City of Phoenix		
City of Scottsdale		
Duncan Valley Electric Power Cooperative		
Graham County Electric Power Cooperative		

	4. Limitation on calculation period?	5. Limitation on recovery period?	6. Who should pay for s/c? Who, if anyone, should be excluded?
Arizona Municipal Power Users Association			
Arizonans for a Better Environment	ABE has no position on this issue at this time. (Not relevant under preferred approaches.)	RUCO proposal or no more than 6 (six) years.	Should be shared by taxpayers and shareholders. Any rate design should reflect efficiency and reliability factors and demands among classes.

	7. Should there be a true-up mechanism? How should it operate?	8. Should there be a Rate Cap/Price Freeze? How should it be calculated?	9. What factors should be considered for mitigation of s/c?
Arizona Municipal Power Users Association			
Arizonans for a Better Environment	Only if administrative approach. If so, provisionally support RUCO's position.	No freeze. Cap if linked to rate reduction, at or below regulated level.	Generally support cost reduction measures to bring embedded costs of generation down closer to market price. (RUCO.) Could support various intervenor suggestions for appropriate refinancing, renegotiation, etc. "Mitigation" effort should be enforceable commitments with penalties for failure to mitigate.

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